STATE BOARD OF EQUALIZATION
STAFF LEGISLATIVE BILL ANALYSIS

Date Amended:	**6/12/00**	Bill No:	**SB 1844**
Tax:	**Property Taxes**	Author:	**Kelley**
Board Position:	**Support**	Related Bills:	

BILL SUMMARY:

This bill would increase the threshold level for mandatory audits from $300,000 to $400,000.

ANALYSIS:

Current Law:

Existing law requires county assessors to audit at least once every four years the books and records of any taxpayer that is engaged in a profession, trade, or business if the taxpayer has assessable trade fixtures and business tangible personal property valued at $300,000 or more. These statutorily required audits are commonly referred to as "mandatory audits."

Proposed Law:

This bill would increase the assessable trade fixture and business personal property owned threshold level for mandatory audits from $300,000 to $400,000.

In General:

AUDIT OBJECTIVE

A property tax *audit* is a means of collecting data relevant to the determination of taxability, situs, and value of property. It is used to verify an assessee's reported cost and other information which may influence the assessment of all items that are taxable under property tax law. An *audit program* is a system used to select and conduct these audits. Both are used to sample property tax assessments to ensure that taxable property and related information have been accurately reported by the assessee and have been properly assessed by the assessor.

The primary objective of the property tax audit is to determine that a correct assessment has been made. The auditor applies generally accepted auditing standards and utilizes generally accepted accounting and appraisal principles in performing these audits. Audits, and the audit program as a whole, help to identify problems, correct inaccurate existing assessments, and increase the likelihood that future assessments will be accurate through improved reporting by the assessee and improved understanding of the property by the assessor's office.

AUDIT SELECTION

An important part of the audit program is the selection of accounts to be audited. As previously discussed, some audits are required by law *(mandatory)* while additional audits (commonly referred to as *nonmandatory*) can be selected by the assessor as a means of sampling the system as a whole.

Mandatory Audits. As required by Section 469 and Property Tax Rules 192 and 193, for assessees owning, controlling, or possessing tangible business personal property and fixtures with a full cash value of $300,000 or more, audits must be completed at least once in each four-year period. However, an in-depth audit is not always required for each year in the four-year period. The auditor may "sample" one year in the four-year audit period. If no material discrepancy or irregularity is found, there is no requirement to audit the remaining years. If a discrepancy is found, the auditor must continue and audit the remaining years unless (1) the discrepancy or irregularity in the "sample" year is peculiar to that year and (2) the discrepancy or irregularity did not result in an escape.

Nonmandatory Audits. Nonmandatory audits are audits not required by law, but are authorized by Revenue and Taxation Code Section 470 and Property Tax Rule 192(e). The Board recommends that these types of audits should be done in addition to mandatory audits since an audit program would not be complete unless it includes a representative sample from all sizes and types of property. Nonmandatory audits are selected at the discretion of the assessor.

Depending on the resources available, it may be difficult for county assessors to complete a large number of nonmandatory audits. Counties may develop criteria for selecting these audits rather than making a random selection. Examples of criteria appropriate for selection may include: identified discrepancies; accounts just below the mandatory audit cut-off; inconsistent, incomplete, or nonfiled property statements; taxpayer's request for audit; and/or selection by type of business.

<u>Background:</u>

The requirement that assessors perform mandatory audits of taxpayers books and records was established in 1966. Initially the threshold level was set at $50,000. The level was increased to $100,000 in 1976, to $200,000 in 1979, and to its present level of $300,000 in 1991.

COMMENTS:

1. **Sponsor and Purpose.** This bill is sponsored by the San Diego County Board of Supervisors. According to the sponsors, the county’s current audit staff is totally engaged in fulfilling the mandatory audit requirements. By raising the audit threshold, the workload for mandatory audits would be reduced, giving the county assessor more flexibility in the use of limited resources and make staff available to audit a number of smaller businesses which have never been audited.

2. **Amendments.** The June 12 amendment reduces the audit threshold from $500,000 to $400,000. The California Assessors' Association had requested that the threshold be reduced to $400,000, and the Board of Equalization supported the Association's request.

3. **Nonmandatory audits may yield more revenue producing audits.** Most taxpayers who are subject to mandatory audits are routinely audited. Thus, these taxpayers generally have a higher level of compliance with property tax law since prior audits have increased knowledge of property tax law. Consequently, an auditor may yield more revenue per hour on nonmandatory audits.

4. **Some counties may treat this change in law as a workload reduction rather than a workload redirection.** Though a redirection of existing resources into non-mandatory audits may yield more productive audits with respect to generating additional revenue, it is possible that this may not be the result of this bill. If the increase in the threshold is interpreted by some counties as an opportunity to reduce workload, assessors' resources in this area could be reduced. Cuts in assessors' audit staff, where the staff already has difficulty in completing their mandatory audit workload, may prevent any staff from being redirected to nonmandatory audits.

COST ESTIMATE:

This bill would not impact the Board's administrative costs.

REVENUE ESTIMATE:

This measure does not have any direct revenue impact. Any reduction or increase would be associated with the findings of the audits. Audits can result in 1) no change to assessed value, 2) an increase in assessed value resulting in a tax bill for additional taxes via an escape assessment, or 3) a decrease in assessed value resulting in a property tax refund of taxes previously paid. Also, as noted above, it is possible that fewer audits in total will be completed rather than the bill's intended purpose of redirecting existing resources.

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This staff analysis is provided to address various administrative, cost, revenue and policy issues; it is not to be construed to reflect or suggest the Board's formal position.